IT 97-12
Tax Type: INCOME TAX
Issue: Audit Methodologies and/or Other Computational Issues

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE	)	
OF THE STATE OF ILLINOIS	)	**No.**
	)	**EIN**
v.	)	**Tax Yr. 12/31/93**
	)	
TAXPAYER	)	
TAXPAYER	)	**Charles E. McClellan**
	)	**Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Synopsis:

This matter comes on for recommendation following the filing of a timely protest by TAXPAYER ("taxpayer") to a Notice of Denial of a refund claim issued by the Department of Revenue ("Department") on September 11, 1996, in response to a claim filed by the taxpayer on or about February 16, 1996. The issue is whether a penalty should be assessed for failure to file and pay estimated tax during 1993. An evidentiary hearing was held on November 15, 1996, after which the taxpayer filed a memorandum in support of its position. Following the submission of all evidence and a review of the record, I recommend that the Department's Notice of Denial be made final.

Findings of Fact:

1. Taxpayer filed Illinois income tax returns for 1991 and 1992 showing a loss carryforward to 1993. Tr. pp. 14, 15.

2. During August of 1992, taxpayer entered into a business transaction in which it exchanged Lake Forest real property it acquired in 1982 for another parcel of real estate and a note receivable. Tr. pp. 10, 11.

3. For federal income tax purposes, taxpayer elected the installment method[1] of reporting to report the gain recognized on the transaction. Tr. p. 11.

4. The note receivable was scheduled to be paid off during the years 1993, 1994 and 1995. Tr. p. 14.

5. The note was paid in full during August 1993, earlier than scheduled, thereby triggering a gain recognizable in that year for federal income tax purposes. Tr. pp. 12, 20.

6. During 1993, taxpayer failed to make estimated tax payments so the Department assessed and the taxpayer paid a penalty of $13,467.20 for failure to file and pay estimated tax. Tr. pp. 2, 17.

7. Taxpayer timely filed its Illinois income tax return (Form IL-1120) for 1993. Tr. p. 6.

8. The taxpayer reported the gain for Illinois income tax purposes as non-business income allocable to Illinois. Tr. p. 13.

9. During the years 1992, 1993 and 1994, taxpayer's books and records were kept on a monthly basis by an affiliated corporation. Tr. p. 19.

10. The financial reports prepared for the taxpayer would have shown the note receivable as an asset at the beginning of 1993 but not at the end of 1993 after it was redeemed. Tr. pp. 20, 21.

11. Taxpayer made the monthly financial statements available to Deloitte & Touche, its outside accounting firm. Tr. p. 24.

12. Taxpayer did not prepare its own federal and Illinois income tax returns but had them prepared by Deloitte & Touche under an agreement that originated in the 1980's. Tr. p. 7.

Conclusions of Law:

The issue in this case is whether taxpayer's failure to file and pay estimated tax for 1993 was due to reasonable cause. The record shows that the taxpayer has failed to provide sufficient evidence proving that it is legally

[1]. 26 U.S.C. § 453

entitled to the refund claimed. Therefore, the Department's denial of the claim should be made final.

With some exceptions not applicable to this case, the statute provides that every corporation, other than a Subchapter S corporation, is required to pay estimated tax for the taxable year if the amount payable is reasonably expected to be more than $400. 35 ILCS 5/803(a). Section 804 of the Illinois Income Tax Act ("IITA") prescribes a penalty for failure to pay estimated tax as required. 35 ILCS 5/804.

The Uniform Principal and Income Act provides relief from the penalty assessment if the failure to pay is due to reasonable cause. 35 ILCS 735/3-8. "Reasonable cause" is determined in each case in accordance with regulations promulgated by the Department. *Id*. The regulations provide that reasonable cause is determined on a case by case basis considering all pertinent facts and circumstances. 86 Admin. Code ch. I, § 700.400(b). The regulations further provide that the most important factor in determining whether there is reasonable cause is the extent to which the taxpayer made a good faith effort to determine the proper tax liability and to file and pay on time. *Id*. A taxpayer is considered to have made a good faith effort "if he exercised ordinary business care and prudence" in determining his liability to file and pay. 86 Admin. Code ch. I § 700.400(c). Whether taxpayer exercised ordinary business care and prudence depends on the clarity of the law and the taxpayer's experience, knowledge and education. *Id*. Reliance on the opinion of a professional does not necessarily demonstrate the exercise of ordinary business care and prudence. *Id*.

At the hearing in this case, WITNESS, taxpayer's vice president responsible for financial reporting and oversight, testified on behalf of the taxpayer. Tr. pp. 5, 6. He testified that he did not prepare the returns but that the taxpayer had an arrangement with its outside accountants, Deloitte & Touche, to prepare the returns. Tr. pp. 6, 7, 8. He testified that it was the responsibility of Deloitte & Touche to advise the taxpayer of any estimated tax

payments that might be due. Tr. p. 9. Throughout WITNESS's testimony he emphasized taxpayer's reliance on its agreement or arrangement with Deloitte & Touche for preparation of tax returns and for tax advice. Tr. pp. 7, 8, 9, 19, 20, 23, 25, 32 and 35. However, taxpayer introduced no documentary evidence of the agreement with Deloitte & Touche, such as an engagement letter or a fee proposal, nor did any employee or principal of that firm testify.

The long standing rule of construction for tax statutes in Illinois is that the Department's findings regarding tax liability, once presented, are *prima facie* correct and the burden is on the taxpayer to provide credible evidence to the contrary. Balla v. Dept. of Revenue, 96 Ill.App.3d 293 (1st Dist. 1981). Oral testimony by itself is not sufficient to overcome the Department's *prima facie* case. A.R. Barnes & Co. v. Dept. of Revenue, 173 Ill.App.3d 826 (1st Dist. 1988). To overcome the validity attached to the Department's findings, the taxpayer must produce evidence identified with its books and records. Copilevitz v. Dept. of Revenue, 41 Ill.2d 154 (1968).

In this case, taxpayer produced no documentary evidence to support its assertion that its failure to file was due to reasonable cause. Taxpayer's witness testified extensively to the fact that taxpayer relied on the arrangement with Deloitte & Touche for tax return preparation and advice. However, taxpayer introduced no documentary evidence of that arrangement, such as an engagement letter or a fee proposal. Also, taxpayer introduced no corroborating testimony from Deloitte & Touche personnel as to their understanding of the arrangement. Taxpayer's testimony without corroboration by the introduction of credible documentary evidence in support of its position is not enough to overcome the Department's *prima facie* case.

Even if taxpayer had introduced copies of its agreement with Deloitte & Touche, it would not have prevailed in this matter. The taxpayer has the primary responsibility to pay estimated tax under IITA § 803. Reliance on professional tax advisors does not necessarily show that a taxpayer exercised ordinary business care and prudence required to establish reasonable cause. 86

Admin. Code ch. I, § 700.400(c). The leading case on the issue is U.S. v. Boyle, 469 U.S. 241, 105 S.Ct. 687 (1985). In that case, the court stated that when an accountant or an attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, the taxpayer can reasonably rely on that information without going to another tax advisor for a second opinion. 469 U.S. at p. 692. However, the court also said, "[O]ne does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due. In short, tax returns imply deadlines. Reliance by a lay person on a lawyer is of course common; but that reliance cannot function as a substitute for compliance with an unambiguous statute." 469 U.S. at p. 693. Finally, the court held, "The failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not 'reasonable cause' for late filing under § 6651 (a)(1)." *Id*.

The estimated tax rules, insofar as they require quarterly payment, have been in the IITA since its enactment in 1969. The rules are unambiguous. There is nothing in the record that indicates the taxpayer ever contacted Deloitte & Touche with regard to its estimated tax liability. Taxpayer has failed in its attempt to demonstrate reasonable cause.

The taxpayers' reliance on Dupont Ventilation Company v. Dept. of Revenue, 99 Ill.App.3d 263 (3d Dist. 1981) is misplaced. In Dupont, the court held that the taxpayer had reasonable cause for not timely changing from monthly reporting of withholding taxes to the state to a quarter-monthly reporting and payment schedule. The case is factually distinguishable from this case because it did not involve a non-filing situation. It involved a situation in which the taxpayer continued to file and pay withholding taxes on a monthly basis although the statute had been changed to require quarter-monthly filing. The court found reasonable cause from a number of circumstances unique to that case, these being that the statute had been recently changed to require quarter-monthly reporting and neither the taxpayer nor its outside firm of accountants were aware of the change. Also, the Department continued to accept taxpayer's monthly filings

without complaint until the following year when the Department audited the taxpayer's books. There are no similar factors involved in this case.

Taxpayer's reliance on Columbia Quarry Company v. Dept. of Revenue, 446 N.E.2d 325 (1982) also is misplaced. The citation 446 N.E.2d 325 is not a citation to a published decision. It is a citation to a listing of the cases disposed of by the Court of Appeals for the fourth and fifth districts on September 20, 1982, by order under Supreme Court Rule 23 without issuing written opinions. If the taxpayer intended to cite Columbia Quarry Company v. Dept. of Revenue, 40 Ill.2d 47 (1968) it's reliance on that decision also is misplaced. In that case the court upheld the assessment of a penalty in connection with an Illinois use tax assessment where the taxpayer's only defense was that it thought it was not liable for the underlying tax.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's Notice of Denial should be made final.

February 10, 1998

Charles E. McClellan
Administrative Law Judge